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INTELLIGENCE MEMORANDUM

Implications of the Present Soviet Economic Problems

Summary

Faced with slower economic growth and a commitment to meet rising consumer expectations and having experimented unsuccessfully with economic reform, Moscow has turned to the West to help relieve its economic problems. Soviet dependence on Western food and technology has grown substantially.

The bad Soviet harvest of 1972 brought to a head a growing dependence on the West that the above-average harvests of 1970 and 1971 had disguised. Brezhnev's program for increasing meat production and bettering the national diet has created a demand for grains that cannot be met from domestic production even in a year of good weather. In order to fulfill their long-run goals for meat, the Soviets will have to import a minimum of 40 million tons of grains over the next three fiscal years in addition to the 29 million tons already contracted for in 1972.

At the same time, the USSR is embarked on a program of importing large quantities of advanced equipment and technology from the West. The Soviets badly need the boost such imports can give to their productivity, which has been holding down their economic growth to a disappointing rate. They particularly need Western technology to help develop Siberia's oil and gas resources, now that

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older fields are rapidly becoming exhausted, and to increase and improve production in consumer industries, which are generally in bad shape. They will probably need considerable help making the new facilities work. To pay for these imports the USSR is looking for credits and joint ventures which will produce exportable goods such as oil, gas, and timber.

There is no evidence that defense plans were affected by 1972's dislocations in the civilian sector or that they will be affected by similar dislocations in the future. The production capacity of the USSR is now so large that even a moderate growth of GNP can support reasonable increases in military spending without undue strain.

The USSR can manage its probable trade deficit of $1.8 billion for 1973 with a combination of credit and gold sales. Any additional purchases of grain in 1973, which will be necessary if the harvest is poor, will create pressures to cut other imports, particularly consumer goods and perhaps Western equipment.

Growing economic dependence is uncongenial to traditional Soviet doctrine. The whole detente policy has been a controversial one, and there are some people, like Shelest, who have opposed it and suffered politically.

Other options, however, are also uncongenial:

(1) The Soviets could try to achieve greater efficiency and growth through reforms, especially in agriculture--but piecemeal reforms undertaken after 1963 did not work and drastic reforms have been politically unacceptable.

(2) They could accept a lower growth rate for GNP and consumption--but this would mean slower growth than in most industrial countries, which would lead to a disgruntled populace at home and a damaged image abroad.

In these circumstances, the short-run course the present leaders probably will take is to make adjustments where pressed--perhaps some cuts in consumer programs or some agricultural reforms--but to try to maintain the broad outlines of current policies.

Soviet dependence on the West does not equate with Soviet dependence on the US. The most critical need from the US over the next year is likely to be grain. If the Soviets were willing to pay higher prices and tap the markets of smaller exporting countries, the US share of grain purchases could be considerably reduced. If pressed for concessions in other areas in return for US grain, they would be more likely to cultivate other suppliers especially over the long run. In the field of technology the reliance on the West is important and growing, but the dependence on US equipment is relatively small as the USSR's requirements can be met for the most part by Western Europe and Japan.

The USSR does need to expand its hard currency exports to pay for grain and equipment imports, and the US is a promising large new market for Soviet products. If certain large joint US-Soviet projects are not undertaken, this would mean slower growth of export earnings and hence the capacity to import Western technology.

The Soviet leadership has already shown itself ready to increase its economic relations with, and to some extent its dependence on, the US in all these areas. This policy is not without its critics. There is a fear in Moscow that the US, more than other Western trading partners, is prone to link economic dealings with political questions. The Jackson amendment directed at the USSR's Jewish emigration policy is a current case in point. Those still wary of US intentions can argue that it is only good business to develop multiple suppliers, and that the USSR can get most of what it wants elsewhere in the world without the political risks of concentrating upon the US.

Supporters of the present policy can also employ extra-economic arguments. They can maintain that growing economic relations with the US are part

and parcel of a detente approach which has already brought the USSR substantial benefits in such areas as Europe and arms control. They can argue that any resulting dependence will be mutual, with US industrialists and farmers coming to rely on the Soviet market and to lobby on its behalf. They can also point out that it is useful and important to develop these relations as a counter to growing ties between the US and China.

The present leaders will probably consider that the present pace of developing relations does not expose the USSR to undue political risks. A different situation would arise, however, if this year's harvest were another disaster. Should a 20-million ton requirement for grain imports arise, perhaps two thirds of this would have to come from the US. In an emergency of this sort (which the Soviets would try to minimize for tactical reasons), Brezhnev would realize that he was the supplicant and that the US might be looking for something in return. At various points across the range of bilateral relations, he might be willing to meet the US a little more than halfway if Washington in its turn made concessions which would save his face. At the same time, the USSR would move to avoid future vulnerabilities of this sort by arranging larger future imports from such other suppliers as Canada, Australia, and Argentina. Thus the US advantage would be short run in nature.

As a worst case, a disastrous harvest could put Brezhnev in deep political trouble. Much would depend, of course, on how his other policies were faring. One cannot predict how such a harvest would affect Soviet policy toward the US; it might push it forward or lead to a retreat, according to the exigencies of Kremlin politics. If Brezhnev were to fall, we are inclined to think that, after a temporary retreat, his policies would largely survive him. A total withdrawal into a fortress Russia does not seem to be a viable alternative for the Soviets. But if the US had sought to press its advantage in the grain trade, the search for other Western alternatives to US supplies would become even more intense.

Introduction

In 1972 Soviet leaders were increasingly preoccupied with economic matters. By the end of the year, the goals of the Ninth Five-Year Plan were in jeopardy as problems in industry and agriculture forced a number of adjustments in economic policy. From mid-1972 on, the news of a failing harvest was the major concern, and the impending downturn in grain production was responsible for the decision to import unprecedented quantities of Western grain. The drought and its aftermath, however, obscured some of the chronic economic difficulties which have curbed Soviet economic growth since the 1950s.

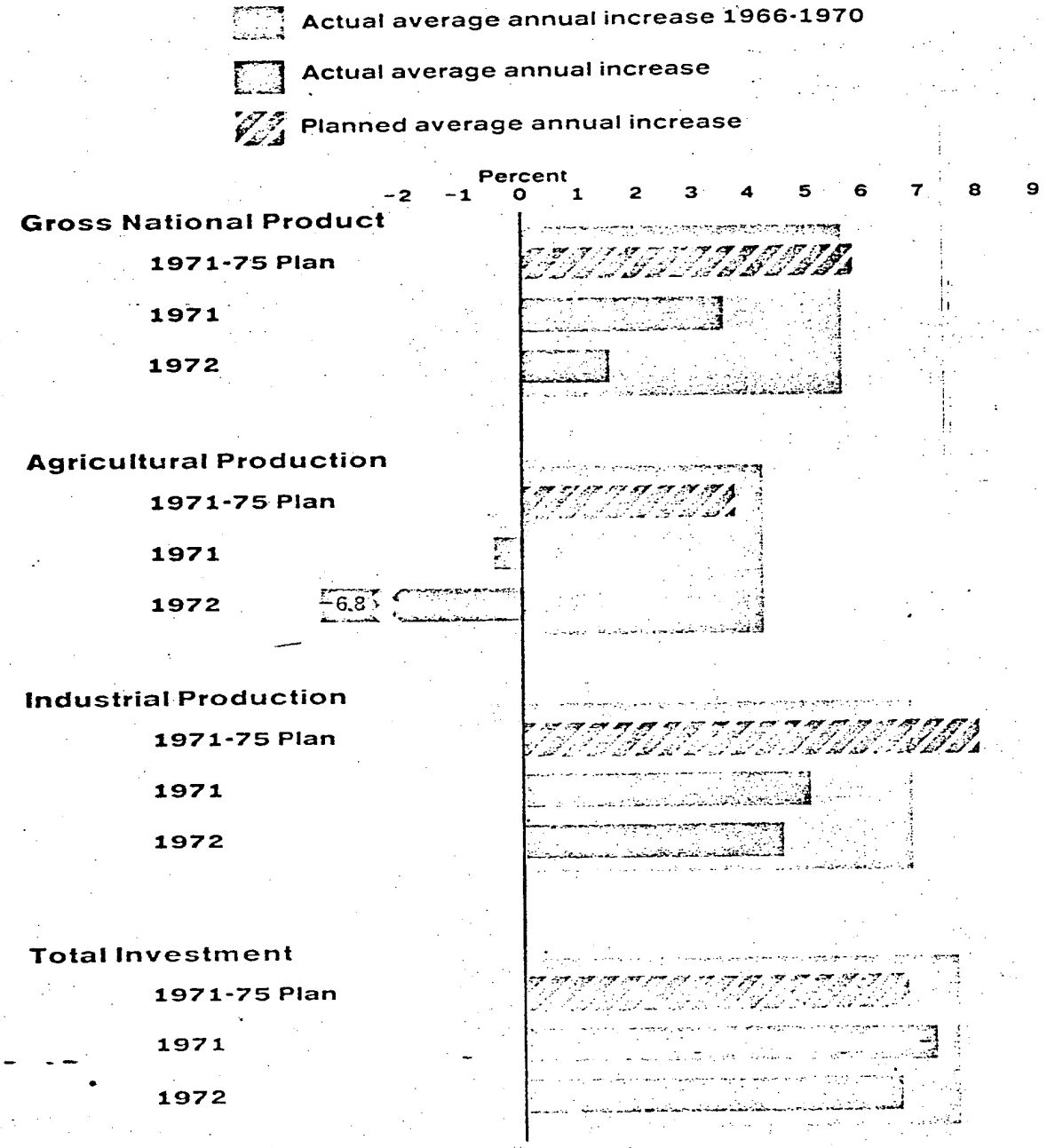
The Soviet Union's central economic problem is that it has passed out of the phase of its history in which it can rely on "extensive" growth--growth based upon larger and larger increments of labor and fixed capital. Since the 1950s the returns to new investment have been declining steadily. Other countries have grown at high rates without increasing capital stock very rapidly; their growth has been supported by substantial productivity gains. These productivity gains--based mainly on technological progress but also on innovations in organization--have been much less influential in Soviet growth during the past 15 years or so. Since the present Soviet leaders assumed power, they have been trying, but with indifferent success, to spur the growth in productivity by internal reforms and foreign contacts.

A second, continuing economic problem for the Soviet leaders is the need to improve the lot of the Soviet population. In so doing, they have had to alter the traditional pattern of Soviet economic growth in favor of sectors which are less efficient and more costly to develop. Brezhnev's commitment to expand meat production is the most striking example of the effect of some consumer-oriented programs on economic growth. The demand for meat (and other high quality foods) has been rising at a very high rate as the incomes of the Soviet population have grown. While the growing demand for meat is a world-wide phenomenon, the cost of producing meat is far greater in the USSR than almost

anywhere else. For example, the USSR needs about twice as much grain as the US to produce a given amount of meat, and, at existing retail prices, meat production is heavily subsidized. Moreover, it takes far more grain to feed a population with meat instead of bread, and the USSR has always had difficulty in growing enough grain even for a bread-based diet.

Thus, the USSR must deal with two separate economic problems in the coming year. First, it must overcome the shortages resulting from the bad harvest of 1972--this is the problem which has absorbed much of the leadership's attention since last summer. Second, in the longer term it must make capital and labor more productive in both industry and agriculture. If the USSR cannot accelerate the pace of productivity growth, it will be unable to prevent a continuing slowdown in economic growth.

Selected Indicators of Soviet Economic Performance



1972--A Disappointing Year

In 1972, a poor harvest and an accumulation of chronic economic problems reduced the rate of growth of Soviet GNP to 1.5 percent--the lowest rate of increase since 1963. This compares with an average annual increase of about 5.5% in 1966-70 and 3.5% in 1971 and must be particularly galling to a leadership whose main shibboleth is economic growth. Almost all sectors shared in the decline, but the drop in farm production and a slower growth in industrial production were most at fault (Figure 1). The slowdown leaves attainment of the goal of overtaking the United States as distant as it was a decade ago when Khrushchev announced it as imminent.

Agriculture--The Leading Trouble Spot

An abrupt decline in farm output was largely responsible for the slump in over-all economic growth in 1972. Net agricultural production dropped almost 7% below the 1971 level, and grain output fell by about 10%. Although Soviet leaders have blamed most of their problems on the weather, it should be noted that 1972 was a poor agricultural year chiefly in comparison with the peak year 1970, a year well-favored by climatic conditions. Even though the percentage decline in crop production was one of the largest in 20 years, the total value of farm output and even grain production were still greater than in all but one of the years of the 1960s. Grain production was only 10 million tons or 7% below the level that would have been predicted on the basis of long-term trends and normal weather.

The drop in agricultural production in 1972 resulted from an unusual streak of poor weather throughout the growing and harvesting season. First, a lack of snow cover combined with extreme cold in late January and February killed almost one third of the area sown to winter grains. These grains usually provide almost one third of total Soviet grain output. The USSR planted a larger than normal area to spring grains to make up for the winterkill, but the "worst drought in 100 years" curbed their germination and growth in European Russia. Record crops in the "Virgin Lands" of Kazakhstan

and Siberia prevented a complete disaster, but the harvest was late. As a consequence, a good deal of the grain was gathered in rain and snow, reducing its quality.

The grain and potato crops, both of which were down, are the core of the Soviet diet and are also essential to the production of meat, milk, and eggs. But the drought also damaged sugar beets and sunflower seeds, the country's primary source of vegetable oil. In fact, the output of all important crops except cotton fell below the levels achieved in 1966-70. The output of livestock products failed to match the vigorous growth achieved in 1971, largely because of tight feed supplies. There was little slaughtering of livestock, however, such as occurred on a massive scale after the poor harvest of 1963 because of feed shortages. By the end of 1972 the number of cattle exceeded the previous year's level, while the decline in hogs, sheep, and goats was held to reasonable proportions.

What made the drop in grain production so critical was that it came at the same time that the demand for grain as livestock feed was increasing rapidly. Use of grain for food has hardly changed for over a decade, but the use of grain as livestock feed increased by roughly 40% between 1968 and 1971 as a result of Brezhnev's 1965 program to provide more meat and other quality foods. By 1969-70, production of grain was not keeping up with demand because of the requirements of the Brezhnev program. Since imports were low in these years, there were deep inroads into the government's reserve grain stocks. In 1969-70, about nine million tons of wheat were released from these stocks for livestock feed, probably reducing them to a dangerously low level.

Thus, the fall in grain output in 1972 left the regime only two choices--to cut deeply into Brezhnev's meat program or to import large amounts of grain from the West. The decision to do the latter clearly shows the high priority the present Soviet leadership gives to improving consumer welfare. The USSR spent roughly $700 million in hard currency to purchase large quantities of grain, sugar, and meat in 1971 and early 1972. Even before the full extent of the damage to last year's grain

crop became apparent, the USSR bought $250 million worth of wheat from Canada and promised to buy at least $750 million of US grain over a three-year period (and at least $200 million in the first year).

All told, their purchases of grain for delivery by mid-1973 reached about 29 million tons, worth about $2 billion in hard currency. This amount is equivalent to roughly two thirds of total Soviet imports from the Developed West in 1971.

Industry and Construction Lag Too

While feeling the repercussions of the harvest, the industrial sector was having problems of its own last year. Continuing a slump begun in 1971, industrial output grew by no more than 4.5% in 1972--the smallest annual increase since World War II. Although a number of industries slowed, the largest slowdown was in the production of machinery and consumer goods. The oil industry did not meet its production goal for the first time since the early 1950s, largely because of an unexpectedly rapid depletion of older fields. The gas industry's production increase last year was the smallest since 1959, and some pipeline construction tasks were not completed on schedule.

The USSR's agricultural situation hurt industry by reducing the flow of some raw materials and by diverting resources away from industry. Industry in 1972 was already on short rations with respect to sugar beets, sunflower seeds, milk, and wool as a consequence of the stagnation or decline of 1971 production. In addition, the above-normal manpower and transportation requirements of the 1972 planting and harvest periods probably held down industrial activity. More industrial workers than usual were detailed to support the farm work, and industrial supply must have been interrupted by the roundup of trucks for agricultural work and especially by the heavy load that the grain harvest in the east and the grain imports put on port facilities and the rail system.

Industrial growth was also held back by the failure to increase productivity and to introduce new plant and equipment on schedule in key sectors.

The plans for 1971-72 explicitly called for an acceleration in productivity growth through the introduction of new technology rather than by raising the rate of investment. These plans were not realized; gains in the productivity of labor and capital in both 1971 and 1972 amounted to about 0.5% per year, considerably less than those required to keep industrial production in line with the five-year plan goals. The productivity plans were frustrated for the usual organizational and political reasons: inefficient management practices, a cumbersome planning system, and the overriding priority given to increasing the quantity of production as quickly as possible to the detriment of efficiency and quality. Introduction of new technology--the key to increased productivity--has been slow.

The construction lag in 1971-72 was not the result of a failure to provide enough investment; almost one third of the nation's gross national product goes toward this end. The problem lies rather in a failure to complete investment projects on time. New projects readied for use in 1972 fell 5.7 billion rubles short of the planned 93.1 billion rubles, adding another 6% to the backlog of unfinished construction (10.3% had been added the previous year). As a result, the growth in new plant and equipment dropped to about 6% in 1972 compared with an annual average increase of 8% in 1966-71.

In recent months both Premier Kosygin and State Planning Chief Baybakov have publicly denounced this investment logjam. In his annual speech to the Supreme Soviet last December, Baybakov complained of the "lag in the commissioning of production capacities, especially in ferrous metallurgy, chemicals, oil, gas, and light industries..." Earlier, in a speech to the State Planning apparatus, Kosygin called for a halt to "unwarranted capital investment" and charged that too many new projects were begun without fully using existing facilities. Although construction lags seem endemic in a "planned" economy, the tendency to start too many projects may have been worsened by the economic reform of 1965 which allowed more investment decisions at the local level at the expense of central control. Decentralized investment

grew at an average annual rate of almost 13% in 1966-70, diverting resources away from centrally planned projects and causing "unbalanced capital development." In an effort to regain greater central control, the growth in decentralized investment was cut to 8.2% in 1971 and 2.2% in 1972. Nevertheless, the response in terms of project completions has been unsatisfactory. The construction sector was not entirely to blame, however. Project completions in some industries--especially in the light, food, and ferrous metals industries--were delayed by the failure of industry to provide the necessary equipment on time.

The Consumer Suffers

Last year must have been disappointing to the Soviet consumer who has been consistently told since 1971 that his welfare is now the prime concern of the state. It was small comfort that the leadership took unusual measures to insulate him from the poor harvest or that the traditionally favored growth-oriented sectors also suffered. He was only aware that his rising expectations had not been met.

In 1972 per capita consumption rose by 3% compared with about 5% per year in the preceding six years. The poor harvest held back food consumption, but no one went hungry. There were sporadic food shortages, but the massive grain purchases from the West and imports of potatoes and some vegetables from Poland and East Germany eased the situation. The government also maneuvered to extract as much farm produce as possible from the private sector. At the same time, the Soviet press launched a nationwide campaign to save bread, and food sales were rationed selectively. It also became apparent that the welfare package introduced at the 24th Party Congress in 1971 was not being implemented on schedule. Plans to raise minimum wages and to cut income taxes have been delayed, and some of the more "expensive" features of the package may have even been shelved.

ECONOMIC IMPACT

Internal Economic Policy in 1973

As the Soviet planners watched the discouraging events of 1972 unfold, they had to decide on the adjustments to make in 1973. The Ninth Five Year Plan had placed unusual emphasis on bettering the lot of the consumer--that is, consumption and consumer-related sectors such as agriculture seemed to be on a more equal footing with heavy industry and investment. Over-all growth was to be maintained by rapid assimilation of new technology and the consequent productivity gains rather than by accelerating growth of capital stock.

The plan for 1973, announced last December, revealed that the leadership had decided to retain the original five-year plan targets and basic priorities while making major revisions in the 1973 goals. The revisions were intended to rectify past errors and get the economy back on track, although this would mean a temporary distortion in sectoral growth rates. This year's GNP growth target is about 7%, in sharp contrast to the 1.5% achieved last year. The planned recovery depends mainly on a 12.6% increase in farm output and an accelerated industrial growth rate of 6.7%. Goals for oil and gas, chemicals, and some consumer and machinery items were cut in recognition of raw material shortages or lags in the expansion of production capacity.

The new plan is specifically designed to deal with the knotty investment problem. First, it calls for a stringent limit on new construction starts. Investment resources are to be concentrated on projects which are already under way and on those "which are decisive to the fulfillment of the Five-Year Plan." To this end, the growth in total investment in 1973 is to be held to 3.5% compared with the nearly 9% implied in the original plan. Secondly, more investment resources will be allocated to the parts of the economy in which projects are most behind schedule. Consumer-oriented sectors such as the processed food and light industries and agriculture will receive an increased share of investment allocations.

Thus, policy statements and investment targets indicate that there will be a continued emphasis on improving living standards. The expected shortages of agricultural raw materials and the construction delays which have restricted the production of consumer goods, however, will force a temporary retreat in the consumer program. In particular, meat production is not scheduled to increase appreciably in 1973. The volume of retail trade is slated to increase by 5% in 1973, compared with 7% in 1972. This slowdown in turn forces a change in income policy. In order to avoid further inflationary pressures, wage increases are hopefully to be held to about half the rate achieved last year.

There is no evidence that defense plans were affected by 1972's dislocations in the civilian sector. The military has always been favored and largely protected from short-run fluctuations in output. Moreover, the production capacity of the Soviet Union is now so large that even a moderate growth of GNP can support reasonable increases in military spending without undue strain. The announced 1973 defense budget of 17.9 billion rubles is unchanged for the fourth year in a row, but this figure does not include a number of allocations normally associated with defense. The most significant exclusion is military research and development, which is funded principally from the science allocation. Soviet science outlays in 1973 are scheduled to be 7% greater than last year. It is estimated that total Soviet defense spending in 1973 will be about 3% higher than in 1972 and will amount to the equivalent of about $82 billion.

Last year's difficulties in the farm sector severely tested the leadership's dedication to its expensive livestock program, but recent policy statements and the new plan goals indicate that they will continue the campaign at least through 1973. The poor harvest last year, however, makes it practically impossible to fulfill even the modest program for the livestock feed base outlined in the 1971-75 plan. With average weather, they would still have to import a minimum of 40 million tons of grain imports over the next three fiscal years to meet the long-term livestock and meat goals. A number of

prominent Soviet trade and agricultural officials have recently admitted to US visitors that the USSR will require long-term food and feed grain imports from the United States "even if we have good harvests."

Meanwhile, the 1973 grain crop is off to a poor start. Last fall, the area sown to winter grains was one-fifth less than planned because of excessively dry soil. Very little snow has fallen this winter in the major winter grain areas, and as of the first week in February there was insufficient snow cover to protect the seedlings from the low temperatures. It is likely, therefore, that the winter grains have already suffered an above-normal amount of winterkill. To recoup winter losses and make up for the shortfall in fall-sown area the Soviets must sow more than 100 million hectares to grains this spring--a record. If they fail to meet the spring seeding schedule and encounter only average growing conditions, the chances are slim for a big increase in production above last year's disappointing harvest of 134 million tons of usable grain.

The Effect of Another Bad Harvest

If a grain crop of 140 million tons or less is harvested in 1973 (as opposed to a "normal" crop of 150 million tons), the leadership will have to make some disagreeable decisions. With a crop of 140 million tons, they could decide to support the meat program again with total imports of grain that could run as high as 20 million tons. At the higher world prices now prevailing, the total cost of importing grain on such a scale in FY 1974 would equal the cost of the purchases made for delivery in FY 1973 (about $2 billion). It is quite possible that the Soviet leaders would not be willing to make this expenditure. With a short crop, however, a failure to import sufficient quantities of grain would mean that livestock would have to be slaughtered--ensuring serious meat shortages in the following years. As the meat queues lengthened, the leadership would have to decide whether formal rationing should be substituted for the hit-and-miss allocations resulting from the queues. Alternatively, they could raise meat prices to avoid the administrative costs

of rationing or the unfairness of a first-come first-serve system of distributing the available supply of meat. In deciding how much grain to buy in the event of a poor harvest, the leadership would have clearly in mind the civil unrest that accompanied Khrushchev's decision to raise meat prices in 1962 and the part that meat supplies and prices had to play in Gomulka's fall from power in Poland in 1970. Very probably, they would not abandon the meat program completely; rather, they would reluctantly accept a lower rate of growth in meat production.

Foreign Trade and Payments Policy in 1973

One of the consequences of the bad harvest is a considerable increase in the USSR's dependence on the West for food supplies as well as advanced equipment and for credit to finance the purchases. As a result of the massive grain purchases the Soviets will have a record hard currency trade deficit of about $1.8 billion in 1973 compared with an estimated $600 million in 1972. (After the 1963 harvest disaster, the 1964 deficit was only $533 million). Besides the $1.6 billion represented by contracts already concluded for grain to be delivered in 1973, the gap between earnings and outlays of hard currency will be affected by large imports of sugar, record acquisitions of Western plant and equipment, and possible new grain purchases in the last half of 1973 (assumed to be about six million tons worth about $500 million).

As in 1972, the 1973 hard currency deficit will be financed by a combination of gold sales, credits, and trade adjustments. Up to 200 tons of gold worth $400 million could probably be sold in 1973 without depressing its price below the average 1972 level. Sales of this magnitude would be about equal to annual production (net of consumption) and would leave Soviet gold reserves unchanged at about 1,600 tons. The major source of financing, however, will be credits, and ample amounts are available throughout the West. The European money market has a surplus of funds for short- and medium-term borrowers. Moscow's Western-based banks also can attract considerable funds at prime rates. In negotiating to buy grain in the US, the Soviet Union will surely

continue to ask for more favorable credit arrangements than have been offered thus far. The United States has emerged as an important creditor in 1972 and 1973, extending about $500 million of Commodity Credit Corporation funds, and US and Japanese banks and financial houses are exploring ways in which they can increase their roles in financing Soviet trade.

The Soviets have tried to prevent the hard currency deficit from interfering with their plans to import Western equipment and technology. There was no clear evidence of a cutback in 1972. In the second half of the year, the volume of new orders declined somewhat from the very high level recorded in the first six months, but large orders for such equipment continue to be signed. Some of the orders involve long-term and self-liquidating credits (repayment in kind) and do not bring immediate pressures to pay. The proposed US-Soviet LNG project and the Japanese-Soviet projects for developing natural gas and oil deposits are examples of exchanges that have no necessary impact on hard currency reserves. The grain purchases put pressure mainly on the USSR's short-term payments position. In 1973, however, as short-term indebtedness increases, it will become increasingly difficult for Moscow to avoid some import cuts. Although the USSR could finance the entire likely deficit, and perhaps more, solely with gold sales and credit, it will probably also make some adjustments in its trade. Imports of consumer goods and other items that are paid in cash are likely candidates for trimming. If the harvest is bad and massive additional grain imports are necessary, cuts in other imports are certain.

In any case, even given average weather agricultural imports will continue to be a major balance-of-payments burden. The indicated grain import requirement might be about 12 million tons a year (worth more than $1 billion), assuming a continued priority for the original Brezhnev livestock program. The prospect of continued imports of grain of such a magnitude may well occasion a re-examination of the long-run wisdom of the meat and consumption programs associated with Brezhnev's leadership.

Longer-term Economic Outlook

Soviet economic growth should turn upward in 1973 because farm output will recover--unless another streak of bad weather intervenes. If average weather prevails over the next few years, GNP should grow by 5% to 6% per year. Even so, the average rate of growth in the first half of the 1970s--perhaps 4 to 5% per year--would be significantly lower than it was in 1966-70. This is about average for an industrial nation, but unimpressive considering the USSR's comparative economic backwardness and the effort it is making. The USSR almost surely would have to abandon many of the agricultural goals and some of the important industrial goals set out in the 1971-75 plan.

In the longer term, the USSR will be hard pressed to sustain a rate of growth as high as 5% per year. The rate of growth of the labor force has slowed and a growing share of all workers is to be employed in the service sector. At the same time, technological progress has not been rapid enough to offset the declining returns to net investment, and there is no evidence that the Soviet Union is finding or will soon find a solution to this problem.

In both industry and agriculture low productivity is caused by organizational factors which discourage efficiency and inhibit the introduction of new products and methods of work. Upon assuming power, the present leadership probably believed that managerial reforms could bring about larger and continuing productivity gains. Then, their attempts to introduce reforms after 1965 were frustrated by the defects of the reform proposals, the opposition of the economic bureaucracy, and the fear of decentralization as a threat to party control. Some careful experimentation with new managerial methods has continued, such as the application of computers to planning, but political controls have prevented public discussion of any comprehensive reform programs relevant to solving economic ills in the near term.

As the interest in internal reform dwindled, the interest in economic ties with the Industrial West increased. The Soviet leaders believe that the shortcut to technological progress and accelerated growth in productivity lies in importing western machinery and technology while promoting other technical exchanges. If carried on consistently over a long period of time this policy will upgrade Soviet economic performance, particularly in terms of the quality of production. Indeed, the most dynamic sectors have depended crucially on imports from the West--for example, chemicals and motor vehicles. Still, the imports will not result in a marked increase in the rate of growth of GNP over the next several years because the contribution of western machinery to total investment is relatively small and limited by the USSR's ability to secure a growing volume of long-term credits. In addition, western technology is not always easy for the Soviet managerial system to assimilate.

Many industrialized countries would welcome a steady growth of national product amounting to 4% to 5% per year, but the Soviet Union would find it hard to abandon the idea that the socialist model provides more rapid development than the arrangements of other industrial nations. In the face of falling growth rates, some officials might be tempted to rely on a higher rate of investment. In the recent past, however, this policy has not been successful in boosting growth. While some proponents of industrial growth probably feel that the agricultural investment program, for example, has been too expensive, a radical shift in priorities away from agriculture or the production of industrial consumer goods would be risky from an economic standpoint. The cooperation and productivity of the labor force depend on continued progress in living standards, especially steady improvement in the diet. On the other hand, the effort to maintain planned rates of growth in consumption clearly will involve increasing dependence on the West, and in particular the United States, for grain.

Soviet Dependence on the US

Soviet dependence on the US is considerably less than its dependence on the West in general. The most critical need over the next year is likely to be for grain. The larger the grain requirement the larger the share that would probably have to come from the US. If the requirement were around 12 million tons, about half would have to come from the US; if it were 20 million tons, perhaps two thirds would have to come from the US. If the Soviets were willing to pay significantly higher prices and tap the markets of smaller exporting countries the US share of grain purchases could be considerably reduced. Particularly, over the longer term, the Soviets could encourage substantially higher production in Canada, Argentina, Australia, etc. with the help of long term contracts. To the extent that the Russians were pressed for concessions in other areas in return for the purchase of US grain, they would be the more likely to cultivate other suppliers.

The reliance of the USSR on the West for advanced equipment and technology is very important and growing. However, the dependence on US equipment is relatively small. By far the largest part of USSR requirements for production equipment can be met by Western Europe and Japan, often at lower prices and with comparable quality. In a few important cases the US enjoys a substantial technological lead: for example, oil production and exploration equipment, advanced integrated circuits, high capacity data processing equipment, and a few specialized types of equipment for truck production. In these cases the USSR would prefer to buy from the US, but the demands are postponable.

Other than as a source of grain, the most important potential role of the US in Soviet eyes is as a market for raw materials and a supplier of credit, equipment, and technology to develop them. The USSR badly needs to expand its hard currency exports to pay for grain and equipment imports. The joint ventures to develop Siberian gas offer the best hope of dollar exports over the long run. Barter arrangements--for example, nickel for machinery--might also become important. There are

other Western markets for these Soviet materials--notably Japan--and other sources of credit and technology. But if joint US-Soviet projects are not undertaken, expansion of Soviet hard currency exports will almost certainly be considerably delayed. In the long-term this would mean a substantially slower growth of export earnings and hence the capacity to import Western technology.

Thus the principal areas of Soviet economic dependence on the US can develop only in the long term, and will then also involve a growing US economic dependence on the USSR. Substantial US-Soviet economic links will increase the Soviet investment in good political relations with the US; at the same time, their development requires that reasonably good relations be maintained for many years. Although the US bargaining position is currently strengthened by the large Soviet dependence on US grain, this major US advantage may not continue beyond the next year or so and its value as a bargaining tool is, therefore, limited.

The Political Outlook

Fundamental weaknesses in the performance of the Soviet economy guarantee that, even with an average harvest in 1973, the leadership will face difficult questions concerning several interrelated issues: the goals for economic growth, adherence to the agricultural and consumer programs, managerial reform, and economic dependence on the West and more particularly on the US. Even with normal harvests, the future needs for foreign grain that will be necessary to support present programs should become even more apparent to the leadership by this summer and the chronic nature of the problem will focus attention on the wisdom or practicality of basic policies.

The situation can only complicate Brezhnev's political life. This is all the more so because he has so strongly advocated the agricultural and consumer programs that are now beset by difficulties. For example, although Brezhnev at the Party Congress justified at length the new policy of consumer goods production growing faster than producer goods under the five-year plan, it appears that this in fact will not occur.

There has been political fallout from the poor harvest. Polyansky was demoted from first deputy premier to minister of agriculture and the incumbent minister, Matskevich was removed. Brezhnev has far greater political resources at his command than do his critics and he seems to have shored up his position for the time being through his successful harvest-boosting trip to the Virgin Lands and Central Asia last fall and through Polyansky's demotion. Nevertheless, Polyansky's demotion means the slippage of a once staunch ally of Brezhnev's. Moreover, it leaves an opening for first deputy premier to be fought over.

The situation favors a revival of public discussion of some policy issues. Polyansky's move could encourage greater efforts to pare down the large agricultural investments he has championed and to press for administrative reforms he has fought. Advocates of some current experiment and reforms in managing the industrial economy will become more active, and institutional reorganization, a traditional panacea in Soviet eyes, will attract more attention.

As the Soviet leaders realize how their dependence on the West for grains and technology is growing and promises to grow in the future, they will face two particular questions on the wisdom or acceptability of the dependence itself. They must consider how much to rely on US sources. They must also contemplate whether they will be pressed to pay for such reliance with political concessions and, if so, how they should respond.

One group will find dependence in general distasteful and reliance on the US especially so. As late as 1968 Brezhnev himself spoke in public for this group, arguing against over-reliance on Western technology. The continued strength of this dogmatic school of thought, which Brezhnev has since abandoned in foreign relations, is shown by the rigidity that has been maintained concerning internal policies and controls even as detente has developed abroad. Officials of this frame of mind

will argue against reliance on US supplies and will cite the opportunity this will provide the US for demanding political concessions--for example, the Jackson amendment. They might also argue that it makes good commercial sense to bargain multiple suppliers off against each other and that in any event their needs could be met by Western Europe and Japan.

The majority of the current leadership, while sharing these concerns, believe that in economic terms the US is the best source of certain supplies wanted by the Soviet Union. Improved economic relations with the US is popular among many Soviet bureaucrats and citizens. Some leaders will argue that the dependence will be mutual since US farmers and manufacturers are greedy for markets and can present their case to the US Administration. The intense interest shown by Brezhnev, Kosygin, and other top leaders in the LNG deal is motivated in part by an assumption that this kind of agreement will increase mutual dependency. These leaders will also maintain that concentrating on the development of US-Soviet economic relations furthers their political interests vis-a-vis the US and acts as a counterweight to growing relations between the US and China.

Although many economic questions may be up for debate, an agricultural year that is no worse than average will make it easier for the top leaders to maintain ultimate control over the issues and maneuvering and thus to protect their own positions. Changes, in this case, would more likely be confined to leaders of secondary or tertiary rank and to economic measures of largely internal significance. As unwelcome as lower growth rates and economic dependence on the West, and the US in particular, might be, Brezhnev and the leadership as it now stands would be loath to abandon the agricultural and consumer programs entirely, considering the consequences this would have on their own political credibility, popular morale, and internal controls. Given an average agricultural year, they will probably opt for making compromises in their economic goals where necessary but retaining at least the general direction of present policies.

This outcome would have a double meaning in foreign affairs. Lackluster economic performance should further encourage Brezhnev and other leaders to seek "successes" in the conduct of detente policies abroad and to cultivate economic relations with the West that promise help in relieving domestic deficiencies. In particular the Soviet leaders will probably continue to turn to the US to supply a growing number of economic needs. On the other hand, serious setbacks in foreign affairs, particularly in relations with the West, would be all the more painful to Brezhnev, especially as they could further call into question the whole complex of inter-related programs he has pursued.

Specifically how might economic reliance on the US affect Soviet behavior? The most likely consequence would be to encourage restraint in the conduct of foreign affairs that touch the US. Thus, considering the state of US-Soviet relations, there are some things that the Soviets might simply choose not to do, for example, taking a provocative stance in support of some allies such as North Vietnam or Cuba.

While growing reliance on trade with the US will increase Soviet motives for being conciliatory on other issues between the two countries, it is very unlikely that this will lead them to make major concession in other areas. Economic interest has been a motive throughout in the Soviet pursuit of detente. It has been difficult to distinguish, however, the effect of this interest on Soviet diplomacy from the effect of other principal motives, such as their goals in Europe, their distrust of China or the political play in Moscow. This will continue to obtain even if the economic factor grows somewhat. Moreover, the Soviet leaders will resist, as they have in the past, discussing linkage between economic relations and specific points at issue in other areas. They will do this not only to avoid a poor bargaining stance but also because they will be wary of those political forces at home who are distrustful of detente and especially of this kind of vulnerability. Finally, the Soviet leaders would probably conclude that important political concessions to the US are unnecessary for economic reasons

since they can obtain most of their import needs from Western Europe and Japan, and that US domestic agricultural and industrial interests are anxious to expand their goals in the Soviet market.

Nevertheless, Soviet eagerness for expanded economic relations with the US will probably continue to make the leadership willing to accede to some modification of policy when circumstances create a direct linkage to economic questions--for example, the Jackson amendment. The modification of the laws on the education tax for emigrants last year illustrates the type of concession and the general range of flexibility that may be expected in the future. Likewise, major advances in US-Soviet economic cooperation would increase the pressure from the US to enlarge the scope and freedom permitted businessmen operating in the Soviet Union, and some give would be likely from the Soviet side on this matter.

Worst Case

In case of a bad harvest, however, the magnitude of the economic problems and the politically unsatisfactory nature of any of the possible measures for dealing with them would clearly exacerbate tensions within the leadership. Regarding the populace, the relative austerity that would obtain for a second year in a row would cause a sag in morale and perhaps even some instances of public unrest. As a result, among the political elite, interest in new policy courses and even new faces at the top would rise.

This kind of internal situation would naturally affect the conduct of Soviet foreign affairs. A loss of self-confidence in dealing with the West would tend to deter the Soviets from making new agreements, although, for lack of a viable alternative, large imports of Western grain and machinery would continue. A strong challenge to the present leadership might for a time freeze Soviet policy in its present course, rendering it incapable of taking new initiatives or responding flexibly until domestic politics were sorted out.

Although their economic needs from abroad and particularly the US would mushroom, the Soviet leadership would probably not be in a position to act on them in any comprehensive way, much less to agree to important diplomatic concessions in this connection. If in fact a political crisis of this sort arose and then was resolved, the eventual implications for foreign policy--a reconfirmation of the detente line or a retreat from it--would depend on who won. In this connection, the objective need for fuller economic relations with the West would be a powerful though not necessarily decisive argument on the side of those defending the present line.